THE FULL SPECTRUM

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EQUIPMENT LIQUIDATIONS:
The Second in a Three Part Series Focusing on Liquidations of Accounts Receivable, Inventory and Machinery & Equipment

Liquidating Machinery & Equipment – Some General Guidelines

Machinery & Equipment is Strong Collateral – Banks and Asset-Based Lenders have long considered machinery and equipment as solid, reliable collateral. This is evidenced by loan advance rates that may run as high as 75-80% of new cost or up to a 90% advance on Orderly Liquidation Value (though a more common advance may be along the lines of 65-75% of Orderly Liquidation Value). However, there are numerous factors that can seriously impact the equipment's value over time. Lenders need to pay special attention to these factors to ensure that the amount of their equipment loan corresponds to the eventual liquidation value of the equipment.

Factors Affecting the Equipment Value at Time of Liquidation – Oftentimes, due to a variety of factors, the liquidation value of the equipment is less than the loan amount. Some of these factors and possible remedies may include:

- The loan amortization has not kept pace with the devaluation of the machinery and equipment in the market place. Remedy: Before making the loan closely consider the depreciation for this type of equipment and shorten the amortization accordingly. Do periodic updates of your appraisals.
- Outside economic forces affect the value of the equipment. Some examples include the economic difficulties faced by a particular industry such as the current conditions in the printing and automotive sectors. Sometimes this results in the perfect storm: economics force more and more of these businesses to fail which leads to a glut of used equipment for sale while the OEMs continue pushing the sale of new equipment. The result is inevitable – seriously depressed sales values. Remedy: Continually monitor the economic vitality of the industries in which you have equipment loans. Get periodic updates of your appraisals and aggressively adjust advance rates accordingly.
- The equipment's condition seriously deteriorates or the equipment is no longer in use. Equipment breaks down over time. Unfortunately, as a company's overall financial condition weakens, this is the most likely time for a business failure and the least likely time that the company will have the wherewithal to quickly remediate equipment failures and/or perform necessary ongoing maintenance. Remedy: Random on site visits by the lender to verify the condition of the equipment and periodic updated on site appraisals.

- The equipment is so large and unwieldy as to be prohibitively expensive to move. They say in real estate that location is everything. Unfortunately the same goes for the very largest pieces of equipment. While this equipment is very expensive to replace, it is oftentimes also extremely expensive to move resulting in far lower recoveries than expected at an auction unless sold as part of a going concern. Remedy: Be very careful in lending against these "fixture like" types of equipment and analyze the potential moving costs very carefully in determining your ultimate advance rate after ineligibles.

Which Appraiser – "Trustworthy" and "practical" are two words that should describe the appraiser you use. The appraiser should earn your trust by diligently preparing appraisals based on real time comparables for each equipment piece as well as real life liquidation experience. He will consider the costs of the eventual liquidation in his values and will be conservative and practical in his approach to what an auction will bring. Furthermore, and potentially the key to picking an appraiser is whether *the same firm can also perform the actual auction if necessary.* This cradle to grave approach means the appraiser must stand by his word as to what the equipment is worth by actually selling that equipment at auction when necessary. If the appraiser has done his job correctly, then his numbers at auction should match up to the original appraisal. Ultimately, be picky in choosing your appraiser and shy away from those firms who merely make sure that their appraisal "makes the number" you need to do the loan.

Selling the Equipment – Practical Considerations - Once it is recognized that the borrower cannot recover from their situation and liquidation is the only answer, the lender must take immediate action to protect their position and collateral. Note that many of the items listed below need to be considered by the lender *before* initially making the loan, i.e. these liquidation considerations and costs need to be analyzed in setting your initial advance rate.

- Confirm Your UCC Priority—An obvious first step in the liquidation process.
- Equipment List—Immediately obtain an updated equipment listing from the borrower.
- Change the locks—The lender needs to protect the collateral from unhappy employees, unpaid vendors, disgruntled owners and others.
- Insurance—Oftentimes this is an overlooked item and frequently the borrower is behind on payments. Insurance is critical and the lender needs to be sure they are named as *Lender's Loss Payee* and to negotiate continued coverage if the policy has or is going to lapse due to nonpayment of premiums.
- Landlord—This is a key consideration ***before*** making the loan, i.e. negotiating a landlord agreement allowing you as the lender access and possession during the liquidation process. Immediately contact the landlord early in the process to confirm the situation. Don't forget to figure this rent in your liquidation cost calculations when making the loan.
- Utilities—Again, the borrower is likely behind on payments here and any liquidation will be impacted gravely if the equipment is not able to be run and tested. Again, quickly investigate this issue and negotiate with the utilities to continue service through the liquidation.
- Personal Property Taxes—In many states these taxes will take a priority over the secured lender's lien on equipment. The lender needs to periodically check the status of these items during the lending relationship and again prior to the liquidation.
- Employees retained—Remember that retaining certain key employees such as the shop foreman can be very beneficial to the overall recovery. These key employees can assist the auctioneer in preparing the equipment for sale and in "testing" the equipment for potential buyers.
- Hazardous Materials—This is another issue that should be considered prior to making the loan. If your borrower utilizes these types of materials in their equipment operations, there will be an expense tied to the removal of these materials prior to the sale of the equipment.

- The Auction Firm—As the auction process can take some time, immediately engage the auction company after negotiating: (a) the scope of the sale, (b) the timing, (c) the costs, and (d) general responsibilities. Do note that the marketing costs can be substantial and typically do not vary much with the size of the auction which means that these costs will have a much larger impact on smaller equipment loans and must be considered in your advance rates. Also, consider whether an on-site or online or combination auction works best for your situation. If your auctioneer will guarantee a certain recovery amount for a fee, consider that option as well. The devil is in the details, so track all of these items closely.

Conclusion—Equipment can be very good collateral for a loan as long as the lender pays attention to the risks when initially making the loan. Consider the economy, the industry, the type of equipment and the costs of a liquidation in setting the advance rate and amortization. Subsequently, if a liquidation is required, pay special attention to the details outlined in this article to maximize your recovery.

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controls necessary to qualify for our typical Asset-Based Line of Credit. This program is basically a hybrid program combining an **Accounts Receivable Financing** accommodation for the A/R with an **Asset-Based Line** on inventory, equipment and/or real estate.

Participation Opportunities:
SPECTRUM continues to offer participation programs that not only benefit the client but the bank as well.

- The bank can choose our **Pro-Rata Participation Plan** whereby the credit will benefit from a blended Bank/SPECTRUM interest rate.
- Under SPECTRUM's **Guaranteed Participation Plan**, the participant bank enjoys SPECTRUM's unlimited corporate guarantee in addition to a first collateral position on all of the borrower's assets. With these strong credit enhancements, the bank makes a solid loan while also acquiring the operating accounts and enjoying the ability to cross sell other bank products. Ultimately, the bank can maintain a relationship or acquire a new one rather than pushing away a potential customer. Further, under this very popular program the participating bank *can ask to be paid out of its participation at any time for any reason, no questions asked.*

Given the variety of SPECTRUM financing programs, we would like to encourage you to give us a call the next time you encounter a **Hard to Finance Credit** and let SPECTRUM put a finance package together that will best suit your client.

<u>Thank You!</u>
Our business comes from your referrals. All of us at SPECTRUM would like to thank you for the referrals you send us.

Give us a call and allow SPECTRUM to be a part of your portfolio solution!